June, 1998

RATINGS:	
Moody's:	**NR**
S&P:	**AA-**

THE CALIFORNIA MORTGAGE LOAN GUARANTEE PLAN (CAL-MORTGAGE PROGRAM)

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The Cal Mortgage program guarantees the payment of principal and interest of the tax-exempt municipal bonds issued by lower credit health care providers from its Health Facility Construction Loan Insurance Fund. However, the ultimate guarantee of payment is the full faith and credit of the State of California. For this reason, the credit rating of the bonds is directly tied to the credit rating of the State. Events such as the Triad Healthcare default have highlighted certain credit concerns for the program. Although investors need to understand the challenges inherent in the speculative loan portfolio of the Cal-Mortgage program, recent events continue to demonstrate California's commitment to the program. As a result, Cal-Mortgage insured bonds can represent investment value in the California municipal market.

The California Mortgage Loan Guarantee Plan

The California Mortgage Loan Guarantee Plan, best known as the Cal-Mortgage program, was established in 1968 to provide credit enhancement to less established healthcare providers in under-served communities. The Office of Statewide Health Planning and Development (the Office") manages the program. Healthcare facilities that participate in the Cal-Mortgage Program are usually of lower credit quality, with many dependent upon Medicaid and Medicare reimbursements for revenue. The Cal-Mortgage program guarantees payment in the event the insured bond's underlying revenue pledge, the revenues generated by the particular healthcare facility, are insufficient to pay the required principal and/or interest loan repayments.

Cal-Mortgage requires each program participant to establish a Debt Service Reserve account (DSR) in an amount that usually does not exceed the maximum annual debt service payment required during the life of the credit-enhanced bond. The DSR is fully funded from bond proceeds at the time the bond is sold to investors. Should the underlying pledged revenues be insufficient to cover debt service, payment would be made from the insured bond's DSR. If the DSR balance is insufficient to make the full payment, the required debt service amount would be provided by Cal-Mortgage from its Health Facility Construction Loan Insurance Fund (HFCLIF). The HFCLIF is funded by the annual insurance premiums charged to program participants for the guarantee, interest income generated by the investment of the Fund, and new business fees. In the event of a default, the Office has strong oversight powers to effect corrective actions. If the default persists, the Office can request the State treasurer to issue debentures to replace the bond. The debentures, or unsecured bonds, would be issued on a parity basis with the State's general obligations, at the same coupon rate as the original defaulted bonds. As a result of this State backing, the ultimate guarantee of payment on Cal-Mortgage insured bonds is the full faith and credit of the State of California. For this reason, the credit rating of Cal-Mortgage insured bonds is directly linked to the general obligation rating of the State.

The credit enhancement that is provided by the Cal-Mortgage program is important to both the healthcare facility and its bondholders. Many of the healthcare facilities that issue Cal-mortgage insured bonds would not otherwise be able to access the tax-exempt market on their own due to their weak financial history. As a result of the Cal-Mortgage payment guarantee, they are able to overcome credit barriers to take advantage of essential low cost, affordable capital in order to continue to provide healthcare services to their patients. The Cal-Mortgage payment guarantee is important to investors because it shields bondholders from the credit risk posed by the individual facilities. Bondholders are also protected from underfunded project risk of the HFCLIF as the Cal-Mortgage program is ultimately backed by the full faith and credit of the State of California.

REPRESENTATIVE CAL-MORTGAGE BONDS

California Health Facilities Authority Issues

AIDS Healthcare Foundation
American Baptist Homes of the West, Series 89
Association for Retarded Citizens
California Autism Foundation
Cedarknoll - Casa de las Campanas
Episcopal Homes Foundation - San Francisco Towers
Feedback Foundation/Olive Crest/Heritage House Pool
Fellowship Homes (Casa de Modesto)
Foothill Presbyterian Hospital
H.E.L.P Group
Henry Mayo Newhall Memorial
Hope Rehabilitation Service
La Palma Hospital Medical Center
Los Medanos Community Hospital
Madera Community Hospital
Marshall Hospital
Mercy Senior Housing (Mercy McMahon Terrace)
On Lok Senior Health and Community Housing
Porterville Family Health Care Network
Sacramento Medical Foundation (Blood Center)
San Diego Christian Foundation (Canyon Villas)
Santa Barbara Medical Foundation
South Coast Medical Center
Southern California Presbyterian Homes
Small Facilities Pooled Loan Program, Series A and B
St. Paul's Episcopal Home, Inc.
Valley Care Hospital Corp.
Valley Memorial Hospital
Victor Valley Community Hospital
Walden House, Inc.

CA Statewide Cmmty Development Authority Issues

AIDS Project - Los Angeles
Cal Lutheran Homes - Carlsbad by the Sea
California Lutheran Homes
Eskaton Properties
FACT Retirement Services - Villa Gardens
Families First
Kiero Nursing Home
Odd Fellow Housing of Napa (The Meadows of Napa)

Local Issues

ABAG Financing Authority - Asian Health Services)
Eden Township Hospital District (Baywood Court)
Inglewood (Daniel Freeman Hospitals)
Kern Valley Hospital District
Lodi Memorial Hospital Association
Los Angeles County (Ins. Health Clinic Program)
Oroville Health Facilities (Oroville Hospital)
Palo Alto (Lytton Gardens Convalescent Hospital
Redlands (Redlands Community Hospital)

Source: Standard & Poor's Credit Week Municipal

Credit Concerns

The Triad Healthcare bankruptcy in 1993 was the first major Cal-Mortgage default, but additional hospitals in the program are experiencing severe financial stress. Cal-Mortgage has paid over $23 million from HFCLIF for debt service on the insured Triad bonds. At the time of the default, Standard & Poor’s raised specific credit concerns, including concerns with respect to the State’s on-going ability and willingness to absorb claims under the program. Concerns originally raised by S&P were: undefined state funding mechanisms, the risk that the State would divert HFCLIF funds for other state budgetary purposes, the poor credit quality and lack of geographic diversification of the portfolio and the bankruptcy risk with respect to preferential payments.

Positive Program Changes and Risk Mitigation Steps

From a credit viewpoint, the ultimate strength of the Cal-Mortgage program remains to be the full faith and credit of California. Cal-Mortgage has effectively addressed the structural concerns raised by S&P with favorable contractual and legislative changes to the program. It has also taken steps to decrease the credit risks of its portfolio and to manage existing and potential defaults. Although S&P is the only rating agency to rate the Cal-Mortgage program, Moody’s Investors Service has recently provided an underlying rating on a hospital issue based on the insurance provided by the program. Both Moody’s and S&P have concluded that the program’s structure mitigates against preferential payment bankruptcy risk.

Cal-Mortgage and state agencies formalized the procedure transferring funds from HFCLIF to the bond trustee when needed in 1994. Additionally, the State legislature passed Senate Bill 1705, guaranteeing that HFCLIF monies could only be used for Cal-Mortgage purposes. The legislature also clarified that debentures issued under the program have a lien on parity with State general fund obligations. In 1996, Cal-Mortgage published a procedure to identify portfolio credits that could require future State debenture issuance and the process to be followed to carry out the required issuance.

Cal-Mortgage has reduced its total project risk roughly 20% since January, 1992. HFCLIF remains underfunded but its balance has increased to an amount representing approximately 7.4% of the total debt insured by the program. It is reported to be sufficient to meet all “normal and expected” expenses of its troubled projects, including the on-going Triad default. Cal-Mortgage management continues to reassess the types of facilities qualifying for new program guarantees, monitor the changing health care environment and identify future program directions.